

Audit of USAID-Financed Alternative Development Activities in Peru

Audit Report No. 1-527-02-011-P

May 15, 2002

Regional Inspector General / San Salvador



U.S. Agency for
INTERNATIONAL
DEVELOPMENT

RIG/San Salvador

May 15, 2002

MEMORANDUM

FOR: USAID/Peru Director, Thomas L. Geiger

FROM: Regional Inspector General/San Salvador,
Timothy E. Cox

SUBJECT: Audit of USAID-Financed Alternative Development Activities in
Peru (Report No. 1-527-02-011-P)

This memorandum is our report on the subject audit.

The report contains no recommendations for your action. The findings presented in the report include that project management used a mid-term evaluation to make changes to program activities and that the team implemented a monitoring system in accordance with USAID policies.

I appreciate the cooperation and courtesy extended to my staff during the audit.

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Summary of Results

The Regional Inspector General/San Salvador conducted an audit to determine how program funds were spent and how USAID/Peru modified its alternative development activities in response to a mid-term evaluation. Also, the audit was to determine if USAID/Peru implemented a monitoring system in accordance with USAID policy (page 3).

The results of the audit indicated that USAID/Peru spent \$121,162,820 through December 31, 2001 on infrastructure, technical assistance, and monitoring (page 4) and that changes were made to the program as a result of the mid-term evaluation (page 5). Related to monitoring, USAID/Peru monitored the quality, timeliness and environmental impact of outputs in accordance with USAID policy (page 6).

Mission management agreed with the report findings (page 7).

Background

Reducing the production of illicit coca in Peru is an objective of the governments of Peru and of the United States. To support this goal, USAID has implemented a \$194.5 million Alternative Development Program (ADP). To date, \$121 million has been expended. The government of Peru has committed \$115.5 million to the program.

The strategy followed to reduce illicit production has three elements: (1) interdiction and law enforcement to disrupt narcotics trafficking and lower the price paid to farmers for coca leaf; (2) eradication to reduce coca cultivation and encourage farmers to plant other crops; and (3) alternative development.

Of the three elements, USAID is involved in alternative development. According to USAID/Peru planning documents, the ADP strategy is premised on the hypothesis that offering coca farmers alternative licit sources of income and employment, coupled with improved living conditions and organized communities with the ability to enforce laws, will lead them to voluntarily abandon coca cultivation and thereby achieve a sustainable, reduced level of coca production.

Audit Objectives

The Regional Inspector General/San Salvador included this audit in its fiscal year 2002 audit plan to answer the following questions:

How have USAID funds been spent under the Alternative Development Program?

How did USAID/Peru implement recommendations made in a mid-term evaluation of its Alternative Development Program to improve program effectiveness?

Did USAID/Peru implement a monitoring system for its alternative development activities in accordance with USAID policies?

Appendix I describes the audit's scope and methodology.

Audit Findings

How have USAID funds been spent under the Alternative Development Program?

Funds were spent under the Alternative Development Program (ADP) in three general categories – social and economic infrastructure, licit economic activities, and program monitoring and support.

According to USAID/Peru's records, accrued expenditures for the three categories through December 31, 2001 are presented in the table below:

Social and Economic Infrastructure	\$59,032,133
Licit Economic Activities	51,208,259
Program Monitoring and Support	10,922,428
Total	<u>\$121,162,820</u>

Expenditures for Social and Economic Infrastructure included rehabilitation of roads, bridges, potable water systems, classrooms, and latrines and strengthening local governments.

In the area of Licit Economic Activities, funds were spent promoting crop substitution (the cultivation of rice, pineapple, cacao, coffee and other products), providing technical assistance to farmers electing to grow crops other than coca, and providing micro-credit loans.

Program Monitoring and Support included expenditures for managing and tracking program results and to support the agency of the Peruvian government tasked with alternative development.

According to mission monitoring records, the ADP completed projects related to the following between 1995 and 2001:

Schools	1,066
Health Facilities	183
Potable Water	309
Sanitation	47
Bridges	127

The ADP also reported rehabilitating 206 kilometers of roads, conducting 171 studies, presenting 375 workshops, and providing technical assistance related to coffee, cacao, and other crops to 13,554 beneficiaries.

How did USAID/Peru implement recommendations made in a mid-term evaluation of its Alternative Development Program to improve program effectiveness?

USAID/Peru used the mid-term evaluation of its Alternative Development Program (ADP) to identify problem areas, to recognize successful components, and to modify the program based on problems and successes noted.

The mid-term evaluation was a comprehensive review commissioned by the ADP team and conducted by PricewaterhouseCoopers (PwC) between May and August 2000. The purpose of the evaluation was to review the design, strategy, achievements, and implementation of the ADP for the period 1995-1999 and to make recommendations to better align and focus resources to achieve program objectives. After the evaluation was delivered, the ADP team identified key themes or areas for improvement to achieve program goals. Actions were planned to address these deficiencies. Key themes included weaknesses or deficiencies in program design and in coordination with the Narcotics Affairs Section (NAS) of the U.S. Embassy in Peru.

Structural changes were made in the program consistent with the findings of PwC's evaluation. Prior to the evaluation, the ADP licit economic activities were focused on crop substitution. In response to the mid-term evaluation, the focus was shifted to household income. As a result, the program pursued activities to increase household income from agricultural as well as non-agricultural sources.

The mid-term evaluation produced a shift of focus in the infrastructure area as well. PwC found in the course of its work that infrastructure projects, once built, were often poorly maintained. As a result, strategies to improve maintenance were developed.

The ADP team focuses on reducing coca cultivation in targeted areas of Peru. As mentioned in the background section, the alternative development piece is one part of a three pronged strategy to eliminate illicit coca production. The other areas, eradication and interdiction, are activities controlled by the government of Peru in partnership with the NAS. Nevertheless, the mid-term evaluation raised the issue that eradication should be limited and used as a last resort. To address PwC's recommendation, USAID and embassy officials indicated that communication has improved coordination between the several parties involved with coca reduction. However, USAID officials indicated that a consensus on the proper circumstances for eradication has not yet been reached.

USAID/Peru also used the evaluation to identify areas of the program that were functioning well. The Association of Municipalities in the San Martin Region (AMRESAM), a local association of government institutions, was identified as a model for improving the capability of local government to meet citizens' needs. The ADP team implemented similar activities hoping to replicate the successes noted with AMRESAM.

Did USAID/Peru implement a monitoring system for its alternative development activities in accordance with USAID policies?

USAID/Peru implemented a monitoring system in accordance with USAID policies to track program outputs for all active contracts.

In accordance with ADS 202.3.4, USAID/Peru implemented a monitoring system that included the following general components:

- monitoring of the quality and timeliness of key outputs, and
- review of performance and financial reports.

To perform monitoring, USAID/Peru has implemented an annual survey and verification activity. At the beginning of each year, the ADP team selected a sample from the projects reportedly completed by program implementers during the year. ADP team members visited the selected projects to verify that they were completed. Additionally, a sample of people who received technical assistance was also drawn. These people were visited to confirm that technical assistance was delivered. The 2001 monitoring efforts were just beginning to get underway at the time of the audit. However, the process followed in 2001 was to be the same as in previous years.

Apart from the annual survey and verification work, USAID/Peru's monitoring system also included review of financial and performance reports, regular contact with program implementers, and frequent site visits.

In accordance with ADS 204.5.4, USAID/Peru implemented a system to monitor project environmental impacts. Under the system, current projects received an environmental impact assessment. In these assessments, potential environmental impacts such as erosion, waste disposal, and water quality degradation that could occur at local project sites were assessed and mitigation proposed.

**Management
Comments and
Our Evaluation**

Mission management expressed agreement with the report findings and reiterated the effectiveness of the monitoring program.

Scope and Methodology**Scope**

The Regional Inspector General/San Salvador conducted this audit, in accordance with generally accepted government auditing standards, to determine how USAID/Peru expended \$121.2 million in alternative development funds, how the mission responded to recommendations presented in a mid-term program review, and if USAID/Peru implemented a monitoring program in accordance with USAID policies.

We obtained an understanding of the management controls designed to ensure that program results were attained. These controls included management review and approval of annual work plans, review of quarterly progress reports, annual verification of program outputs, frequent site visits, and regular progress meetings.

We examined project-to-date financial reports to determine how program funds were spent. We determined, based on management input, which recommendations for the mid-term evaluation were accepted, and we examined work plans and quarterly reports to determine the progress made implementing accepted recommendations. We tested all open contracts or grants to determine whether USAID monitored the agreement during the 2001 calendar year as required by USAID policy.

The audit was conducted at USAID/Peru from February 19, 2002 through March 7, 2002.

Methodology

In conducting the audit, we interviewed mission management personnel and reviewed annual work plans, annual reports, and other project documentation.

We identified four monitoring activities that we judged to be a minimum level of monitoring required by USAID policy, the ADS. To determine the significance of our findings, we judged that we would issue a positive opinion if USAID/Peru performed the following monitoring on all contracts or grants:

- for contracts, the mission developed a Contract Monitoring Plan (ADS 202.3.4.1);
- for contracts and grants, the mission reviewed performance and financial reports from the implementers (ADS 202.3.4.1 and 22 CFR 226.51);
- for contracts and grants, the mission assessed the quality and timeliness of key outputs (ADS 202.3.4 and 22 CFR 226.51); and

- for contracts and grants, the mission obtained and reviewed reports that show changes in environmental quality, positive or negative, during the implementation of the activity (ADS 204.5.4 and 22 CFR 216).

Our opinion would be negative if less than 85 percent of the contracts or grants we reviewed met the minimum. The report would be qualified if more than 85 percent, but not all the contracts or grants we reviewed, met the minimum.

**Management
Comments**

May 13, 2002

Mr. John Vernon
RIG auditor
San Salvador

The following are USAID Mission Comments on the draft IG Audit Report for the Alternative Development Program.

“The Alternative Development Program (ADP) is a US\$194.5 million effort to achieve sustained coca reduction in Peru. ADP forms part of a two-prong strategy of interdiction to drive farm-gate prices of coca leaf down and alternative development to permanently dissuade farmers from the coca economy through a competitive array of economic benefits, infrastructure and participatory institutions. The problems addressed by the Program are complex, politically sensitive and highly visible. The Mission worked hard to put appropriate systems in place to 1) ensure appropriate programming and financing of activities, 2) effectively evaluate and correct program weaknesses, and 3) establish a reliable program performance monitoring system. We are pleased that Regional Inspector General Office/San Salvador found ADP adequately addressing these three areas”.

Thanks again for your review on the AD Program.

Sincerely yours

Michael Maxey
Chief Development Alternative Program